

ANALYSIS OF FRANCHISING EFFORTS IN FLORICULTURE

F420
F813

New
OARDC

02099

DR JERRY ROBERTSON
ASSOCIATE PROFESSOR
DEPARTMENT OF HORTICULTURE

DECEMBER 6, 1979



The Ohio State University

639
643

This page intentionally blank.

An Analysis of Franchising Efforts in Floriculture

Jerry L. Robertson
The Ohio State University

Overview. Franchising of retail flower shops remains relatively new. Only since 1970 have there been any developments in local and regional efforts to franchise flower shops and florist related retail businesses. Even today, after major efforts of individuals to franchise flower shops, the successes have been minimal and the failures have been great.

Franchising has been very successful in other retail businesses. Successes have been great in types of retail businesses that can maintain a uniform product throughout the U.S. and where a retail operating system can be packaged and sold. The more common franchising efforts include muffler shops, such as Midas, fast food chains, such as McDonalds, hardware rental, such as Taylor Rental, and travel, such as Kampgrounds of America.

The net return as a percent of sales for franchises is usually greater than 10% for most businesses. This makes the franchise business very attractive for the large number of people who have entrepreneurial ambitions. However, many franchises require an initial capital investment of millions, which precludes most persons from getting into the businesses which have the most potential. Certain franchises sell for a nominal amount such as Tidy Car, a traveling wash, polish and touchup car service, which sells for only \$888. This franchise fee usually only gives the rights to use the franchise name, process, patents or trademarks to the franchisee.

Most franchise sellers require buyers to supply 25% to 50% of the initial capital investment in cash. The remaining portion can be financed in various manners. Typically the franchise buyer pays a royalty based on sales, usually 5% to 12%, to the franchisor. Therefore, the franchisee has paid an investment on the

rights to the franchise, pays a continuing fee for the rights and receives goodwill from the use of the franchise name, process, patent or trademark.

In floriculture, efforts to franchise have focused on Buning the Florists, Inc. and Flower World of America, Inc. Arthur Stone has developed the successful Buning system of company owned stores and franchised stores in Florida. Buning has 23 franchises and 9 company owned stores. The Buning franchising operation started about 7 years ago and aggressively expanded both company owned and franchised stores and a wire service network during the early 1970's. Arthur Stone indicates that current franchises cost \$15,000 and all franchises are successful. Buning franchise efforts have been limited to Florida.

Flower World of America has aggressively sought new franchise buyers throughout the U.S. Over 300 known Flower World franchises have been sold since the initial franchise efforts in the early 1970's. Flower World continues to seek new franchise buyers and these efforts will be discussed later.

With the exception of the Buning operation in Florida, franchising efforts have not been a great success in floriculture for numerous reasons. The industry, in general, has specific characteristics which make it difficult to assemble a package of start-up, marketing and management materials applicable for a business that varies by market and site as to the degree of service, merchandising and manufacturing required. For example, most florists have to adapt their business plan to the demands of their individual market. Some customers demand more service while other customers desire lower price. Some customers desire more high-style while others prefer casually arranged and unarranged flowers. Location strongly dictates whether the marketing program requires a strong merchandising emphasis or a strong phone selling emphasis. These variables make it very difficult to put together a uniform quality business operation package that will meet the needs of potential entrepreneurs

in vastly differing markets.

The floral business remains extremely seasonal, which frequently complicates the management of the business. Labor is difficult to handle in a seasonal operation that requires large amounts of part-time help. Labor use is extensive, accounting for over 20% of the average sales dollar. Purchasing requires complete knowledge of the local market which few franchisers can provide for the franchise buyer. Losses can easily occur if the seasonal balance of labor and purchasing is not handled properly. Also, if the price of flowers goes up slightly or a few extra are added to an arrangement, losses can easily result.

The floral industry is no longer a growth business and as a result, average profits are fairly low. Low profitability in a business that requires many transactions means experience and knowledge are needed for a good return on invested capital. Franchising is normally best suited for growth industries where profits are higher than normal.

Lastly, the retail florist business is composed of over 26,000 businesses not including mass marketers. These firms are competing for a market that has witnessed only modest expansion in the last decade. Competition will remain keen in the future because research indicates that fewer people are buying floral products and inflation will continue to squeeze profit margins. The average firm size has less than \$100,000 in sales and new market entries generally find success slow. Customer royalty is high. Therefore, franchising in floriculture remains less viable and a questionable business practice.

However, Robert Sheets has and still makes strong attempts at franchising retail floral businesses nationally and what follows is an analysis of these efforts and Flower World of America, Inc. operations.

Flower World of America, Inc. According to the promotional literature Flower World of America, Inc., (also known as Flower World, Inc.), is located at 1655 Imperial Way, Mid Atlantic Park, West Deptford, New Jersey, 08086. The firm is owned by Robert Sheets. Flower World of America did \$2.9 million in sales for 1978 and \$3.4 million in sales for 1979 (unaudited). The firm had a before tax profit in 1978 of \$82,000 and \$76,899 in 1979. A Flower World franchise originally cost \$7,500, but is reported to now cost \$15,000.

Flower World started as Bob Sheets and Co. in 1959 with 3 retail shops in New Jersey. The first franchise was sold in 1969. Then, Mr. Sheets changed the name to Flower World, Inc. In 1975, Mr. Sheets transferred operations to a new firm, Flower World of America, Inc. A separate company owned by Robert Sheets includes 8 company owned stores: 2 in Philadelphia and 6 throughout New Jersey.

In 1973, Flower World, Inc. sold the rights to franchise flower shops in Kentucky, Tennessee, Indiana, Illinois, Missouri, Ohio, Michigan, Minnesota, Wisconsin, and Iowa to a firm referred to as Midwestern Flower World, Inc., located in Lexington, Kentucky. This agreement gave exclusive rights for the sale and operation of franchised Flower World shops to Midwestern Flower World.

However, the record shows that Mr. Sheets began selling franchises in these states under the new name of Flower World of America, Inc. In 1975, Midwestern Flower World sued Flower World of America, Inc. for \$1.5 million for breach of contract. On May 15, 1979, Judge Charles Allen in the U.S. District Court for the Western District of Kentucky ruled against Robert Sheets and Flower World of America in a default judgment. This means that the case was decided in favor of Midwestern Flower World without considering the merits of the case. Mr. Sheets failed to cooperate with the court and changed legal counsel twice. The court stated, "Mr. Sheets willful failure

to follow the directives of the Court is established... We believe that Mr. Sheets behavior in this litigation cannot be condoned." Thus, the ultimate sanction of default judgment was imposed in the case, while damages to be paid by Mr. Sheets have yet to be determined. Independent of this set back, Mr. Sheets continues to sell franchises nationwide.

Prior to 1977, a Flower World franchise cost \$7,500 and they are now reported to cost \$15,000. This includes licensor's services to time of store opening including:

- site selection and lease assistance
- training program
- instructions on store display
- accounting and reporting procedures
- assistance in advertising
- company personnel for grand opening

When franchises sold for \$7,500, \$5,000 of this original franchise fee went to the salesman selling the franchise and the remaining \$2,500 was to cover Flower World of America assistance. Flower World franchise buyers were never told that 67% of the original fee went directly to the sales agent. However, this is typical of many franchises and reflects the high risk and expense of interviewing many potential buyers.

Flower World of America estimated initial start-up expenses excluding the franchise fee to be the following:

Refrigeration	\$3,200
Fixtures, Sign, and Cash Register	\$4,000
Grand Opening Advertising	\$1,000
Lease Deposits	\$2,000
Basic Inventory	<u>\$7,000</u>
	\$17,200

So prior to 1977 for \$24,700 franchisees received a fully stocked Flower World of America franchise with most of the start-up materials purchased from Flower World of America.

The Flower World of America franchise program includes a number of commitments including a complete management training program for 4 weeks in various locations. This has always been held in West Deptford, New Jersey, which results in an additional large expense to the out-of-state franchise buyer.

The franchisee also pays 5% of gross sales for the life of the Flower World contract which is 10 years. This royalty fee allows the franchise to receive a number of services including continuing management advice from Flower World of America and a monthly newsletter.

Flower World also promises a National Promotion and Ad Campaign. Prior to 1977, franchises were required to submit a detailed monthly financial report within 7 days following every month of which 5% of gross sales or a minimum of \$200 per month went to Flower World of America, Inc. for advertising. A portion of this was rebated to the franchisee for local advertising, while the remaining amount went to the national program. After 1977, Flower World franchisees had the option to sign a new contract agreement that eliminated the \$200 per month minimum advertising fee. In lieu, they are obligated to spend 4% of sales on local advertising and 1% is submitted directly to Flower World of America, Inc.

However, the only "national" advertising program to date has involved placing flowers on the sets of nationally syndicated TV game shows and receiving credits at the end of the show. There has been no Flower World of America national program with local tie-in ads and materials.

In promotional literature, Flower World of America has implied membership in FTD will follow the purchase of a franchise. In fact, FTD rules

state that a florist must be in business for one year to qualify for FTD membership. However, this has not stopped Mr. Sheets from attempting to get a franchise in FTD by stating that a new franchise was a branch shop of Bob Sheets. In fact, in a letter to a franchisee dated November 8, 1975, Mr. Sheets states to the owner of the franchise, "when you are interviewed (by the FTD membership representative), you should give your name as the manager of the store..the owner is Robert Sheets... The reason we are doing this is to expedite membership for your particular shop." This worked until June 16, 1976 when all franchises that had received FTD membership were canceled by FTD. Yet in July 1976, according to a complaint filed against Flower World in a court in Franklin County, Ohio by Richard and Virginia Ziegler, first year membership in FTD was still being promised by Flower World representatives. A key to selling a franchise was FTD membership, as the basic promotional literature states "Flower World, Your FTD Florists."

Another key to selling a Flower World franchise is the prospect for a good profit. Exhibit A is one of the 1976 financial statements provided in promotional literature from Flower World of America. Flower World suggests that a new florist can do \$100,000 in sales the first full year in business. The bottom line shows a \$25,275 return to the owner on \$100,000 in sales. Particularly noticeable is the advertising fee of 5% or \$5,000 and royalty fee of 5% or \$5,000. However, in the author's opinion, Exhibit A underestimates the cost of sales and overhead expenses and no wage for the owner-operator has been included as an expense. On a sales volume of \$100,000 a fair wage expense plus a part-time labor expense would be \$20,600 on \$100,000 sales volume.

Exhibit B contrasts the small typical first year operation to Flower World projections. The modified statement includes the typical costs plus the royalty and advertising charges of Flower World of America.

A typical non-Flower World florist could generate a profit after their own salary of 2.9%, the first year whereas a Flower World franchise after the owners salary, will probably loose \$5,000 on \$100,000 due to the high advertising and the royalty charges.

Exhibit C compares overhead expenses for a Flower World franchisee and a typical non-Flower World florist business.

Flower World of America, Inc. and in particular Robert Sheets has been charged with alleged fraud by numerous franchise owners. The primary allegation stems from untrue statements of material facts and misleading statements omitting material facts in the prospectus and other materials provided by Flower World of America, Inc. These are to have alleged to include:

- over statement in the value of Flower World membership
- misleading projections of 200 members by 1976, 500 by 1977 and 1,000 by 1978
- violation of exclusive franchise agreements with Midwestern Flower World as well as individual franchises
- overstating the quality standards in a Flower World franchise system
- promises of initial membership in FTD
- an advertising program of national scale
- over statement of collective purchasing power
- over statement of management and marketing advice
- short changing franchisees on the quality and quantity of services

The overall problem stems from Robert Sheets and Flower World of America, Inc. not delivering promised benefits for advertising and royalty fees. As a result, the franchisees state that they undergo initial and severe financial stress often resulting in failure of the business. Robert Sheets has refused to answer questions regarding the number of franchised

Exhibit A

FLOWER WORLD
PROJECTED INCOME AND EXPENSES
ON SALES OF \$100,000

SALES:

GREETING CARDS & GIFT ITEMS	\$ 25,000	
FLOWERS, PLANTS, FRUIT & RELATED ITEMS	75,000	
TOTAL GROSS SALES	<u>\$ 100,000</u>	<u>\$ 100,000</u>

COST OF SALES:

GREETING CARDS, GIFTS AND/OR CANDLES	\$ 12,500	
FLOWERS, PLANTS, FRUIT & RELATED ITEMS	26,250	
	<u>\$ 38,750</u>	<u>- 38,750</u>
GROSS PROFIT ON SALES		<u>\$ 61,250</u>

OTHER INCOME:

DELIVERY CHARGES	\$ 1,000	
COMMISSION ON OUTGOING WIRE		
BUSINESS: PROJECTED \$10,000 VOLUME	2,000	
SERVICE CHARGE ON OUTGOING WIRE		
BUSINESS: PROJECTED 1,000 ORDERS	1,500	
TOTAL OTHER INCOME	<u>\$ 4,500</u>	<u>+4,500</u>

GROSS BEFORE EXPENSES		<u>\$ 65,750</u>
-----------------------	--	------------------

PROJECTED EXPENSES

GROSS PROFIT BEFORE EXPENSES		<u>\$ 65,750</u>
LESS THE PROFIT ON \$10,000 PROJECTED SALES FOR		
OUTGOING WIRE BUSINESS	<u>\$ 6,500</u>	<u>- 6,500</u>
		<u>\$ 59,250</u>
WAGES OTHER THAN OWNERS	5,000	
RENT	7,800	
DELIVERY AND AUTO	1,500	
COMMISSION (INCOMING WIRE BUSINESS)	1,000	
ADVERTISING	5,000	
DEPRECIATION	1,500	
OFFICE (POSTAGE, STATIONARY, ETC.)	1,000	
INSURANCE	1,000	
HEAT AND LIGHT	1,200	
PAYROLL TAXES	375	
ROYALTY FEE (5% OF GROSS SALES)	5,000	
INTEREST	1,500	
ACCOUNTING	1,000	
TELEPHONE	600	
WIRE EXPENSE	400	
BANK CHARGES	100	
BAD DEBTS	1,000	
TOTAL EXPENSES	<u>33,975</u>	<u>\$ 33,975</u>
TOTAL		<u>\$ 25,275</u>

Exhibit B

Income Statement

	<u>Typical</u>	<u>Flower World</u>	<u>Modified</u>
Sales	\$100,000	\$100,000	\$100,000
Cost of Sales	48,500	40,750	48,500
Gross Margin	51,500	59,250	51,500
Salaries	20,600	5,375	20,600
Occupancy	8,000	9,000	8,000
Advertising	2,100	5,000	5,000
Misc. Selling	800	--	800
Commissions	1,600	1,000	1,600
Delivery	4,900	1,500	4,900
Other Overhead	10,600	8,100	10,600
Royalty	--	5,000	5,000
Net Profit	\$ 2,900	\$ 25,275	(\$ 5,000)

Exhibit C

Overhead Expenses

	<u>Flower World</u>	<u>Typical</u>
Depreciation	1.5%	2.0%
Wire & Telephone	1.0%	1.6%
Office	1.0%	1.4%
Insurance	1.0%	1.0%
Interest	1.5%	0.5%
Other	<u>2.1%</u>	<u>4.1%</u>
	8.1%	10.6%

Flower World of America franchises and the number of failures. Prior to 1977, the Flower World contract franchise ran for 10 years and only Flower World of America could terminate the agreement without the franchisee ceasing operations at the location in question.

Many franchises have proceeded to go under a separate name, thus violating the contract. The newsletter of Flower World of America only shows two references to closings: In the October, 1976 newsletter they state ... "the very few that are closing are those that do not really want to work." In the July 21, 1977 newsletter, the following closing was reported: "Agnes Scheu, East Chester, New York is closing her store at the end of July. We are sorry to see any store close; however, if it is a business decision made by a particular person to close their store, we can only wish them well in what they do. Agnes has been a licensee for a couple of years, and I only wish that she had spent more emphasis on her shop instead of taking her time to fight the program." Agnes Scheu closed her shop after losing an arbitration dispute with Flower World of America.

The key to keeping franchisees in the Flower World program is a clause in the contract that states that in the case of a dispute either party must settle by arbitration in Gloucester County, New Jersey under the Federal Arbitration Act.

Flower World and Arbitration. This is a discussion of arbitration, the major instrument used by Flower World of America to maintain order and keep franchisees in the program. The instrument is a clause in the contract that stipulates that any dispute between Flower World of America and a franchisee must be settled by arbitration in Gloucester County, New Jersey under the Federal Arbitration Act. This arbitration clause necessitates that a franchise owner must physically go to New Jersey to resolve all conflicts. This is a major obstacle because in most cases, it precludes any legal recourse

between Flower World of America and a franchise stipulating that a third party arbitrate the point of conflict. The American Arbitration Association handles the arbitration. The third party has no formal legal background in franchising and are usually attorneys. However, the arbitration remains binding even though no court action is involved. Because the arbitrators usually have no knowledge of franchising, the results of arbitration by people experienced in fraud and contract law have been highly suspect.

In a Franchise Offering Circular for Prospective Franchisers required by the state of Maryland, Robert Sheets states that there were as of August 30, 1979, 139 Flower World licensed shops in operation. There were at least 78 cases of arbitration between Flower World of America and franchises from May 28, 1976 to August 1, 1979. This represents 78 disputes with only 139 declared franchises in operation. All but one of these arbitration disputes were started by Flower World of America against a franchisee. Most of the disputes were settled in favor of Flower World of America. The one known case started by the franchisee was awarded to Flower World of America. The arbitration clause has remained the major tool protecting Flower World of America from litigation.

The Flower World of America Newsletter makes several mentions of the use of arbitration often in an intimidating manner. In the May 18, 1977 newsletter, the following reference to arbitration was made.

"We have received questions from franchisers asking us about various arbitration hearings that they have been hearing about. There have been two states with disgruntled franchisers and there have been defiers of the system and ones that tried to turn others against us.

Arbitration has been referred to as blackmail, however, nothing is wrong with arbitration. If you know anything about our court system, you are sure to learn you can be tied-up in court for a period of seven to ten years and only lawyers win.

Arbitration should not be used unless every method of settling the dispute has been tried first. To date, everyone we have put in arbitration, each case has been in our favor."

While this last statement by Mr. Sheets was true when stated, arbitration in progress at that time was decided against Flower World of America.

Mr. Sheets continues:

"Flower World has been around for a long time and it is a shame some attorneys do not realize arbitration is binding and not dirty...

...we are proud of our record that no one has found us to be in violation of anything at anytime.

...we wish that some in the system would run their shops better and stop spending their time downing the system.

Misery likes company and in the Flower World business, the only way to success is by hard work."

Despite Mr. Sheets' newsletter reassurances concerning the use of arbitration, it is apparent that he has used the clause to keep the franchisees "in the fold."

Flower World of America has been investigated by several agencies. The December 2, 1977 newsletter states that the company has been under investigation but nothing has been proved wrong. In the July 20, 1978 newsletter, Mr. Sheets states..."It is untrue that we have been stopped from selling franchises in the state of Maryland."

"It is amazing what extent some people will go to try to demoralize the system... We have been through investigation by the Attorney General, the Federal Trade Commission, and you name it, but I guess that goes with a growing company, and with fame in any industry or profession."

While Mr. Sheet has been investigated and with the exception of the case with Midwestern Flower World, he has not lost any court case that is in the public record. However, a class action suit is pending against Flower World of America and Mr. Sheets in the Federal Court in Baltimore. Arbitration has prevented any and all litigation with the exception of one court case that was not dismissed due to the arbitration clause. Richard and

Virginia Ziegler sued Flower World of America, Inc. and Robert Sheets in Franklin County, Ohio in 1978. They claimed that their dispute should remain in court and out of arbitration due to two important arguments. First, persons in the past had bought Flower World franchises as an investment for future resale. Thus, the sale of a Flower World franchise could be an investment contract which makes the Securities and Exchange Act of 1934 and the Securities Act of 1933 applicable. This negates the use of arbitration to settle a dispute. Secondly, the Zieglers claimed that Mr. Sheets had maliciously inserted the arbitration clause to further and continue a fraudulent scheme against the Zieglers.

The Ziegler case was the first known case against Mr. Sheets not to be thrown out of court and has subsequently been settled out of court to the satisfaction of the Zieglers.

In the November 6, 1978 newsletter, Mr. Sheets states that there are 300 Flower World licenses sold. As of August 1, 1979, he reported in the Franchise Offering Circular to the state of Maryland, that there were 139 in operation. This difference could be due to many reasons, but certainly Mr. Sheets has not achieved his goal of 500 memberships by 1978 and 1,000 memberships by 1979.

Mr. Sheets has claimed that many Flower World franchisees are successful and profitable. While there are testimonials to this claim, many franchisees are openly unhappy with the operational procedures of Flower World of America, Inc. Certainly successful franchising in floriculture remains difficult and the key to future success remains the same as in any other type or retail franchise, a strong franchisor-franchisee relationship where services and products are provided when promised and purchased.

Author's Note - All information on Flower World in this analysis came from the public record. General information on franchising came from the November, 1979 issue of Money magazine.

This page intentionally blank.

This page intentionally blank.

This page intentionally blank.